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SUBJECT: TURKEY'S ECONOMY: CONCERN WITH RESOLUTION OF TWO
LARGE BANKS

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¶1. (SBU) Summary: Bankers and financial analysts in Istanbul January 23 pointed to the lack of resolution of two problem banks - Pamukbank and Yapi Kredi Bank, both owned by the Cukurova Group - as the single biggest problem at present for Turkey's reform program. The Cukurova Group refuses to give up its 45 percent share of Yapi Kredi Bank as part of a deal to repay its \$5.2 billion debt to the two banks; the banking board (BRSA) sees its options as limited in the absence of political-level support from the GOT. Resolution of the two banks is a key condition under the IMF Fourth Review and the GOT must act soon, to either persuade Karamehmet to come to terms with the BRSA or take over the nearly insolvent Yapi Kredi Bank. End Summary.

¶2. (SBU) Disbank CEO Tayfun Bayazit (an upcoming banker in mid-forties) summed up the reform situation on January 23 as follows: "the government will somehow come close on the budget to satisfying the IMF, it will probably drop the worst of its Procurement Law changes and find other ways to help its businessmen. But there is no way around dealing with Yapi Kredi and Pamuk." Like others in Istanbul, Bayazit worries about the lack of decisive action by the GOT and its banking board, the BRSA, in resolving these two large banks.

The Offer: A Debt-Equity Swap, But No Penalty for
Non-Acceptance

¶3. (SBU) BRSA Vice Chairman Pazarbasioglu told us January 22 that the banking board is reluctant to take further action on the two banks without signs of political-level support from the government. The BRSA made a proposal to the Cukurova Group: the BRSA would forgive the Group's \$2.7 billion debt to Pamukbank if the Group would give the BRSA an "equivalent" amount of equity shares in the Group's other holdings (which include controlling interests in Yapi Kredi Bank, Turkcell, broadcast and print media, an internet service provider, and construction equipment manufacturer, among others). The deal also involves the Group dropping its law suits against the BRSA. Following the deal, the BRSA would allow the Group to restructure its other debts (\$2.3 billion to Yapi Kredi, \$200 million to other BRSA-controlled banks). But the BRSA has set a January 31 deadline for the offer.

¶4. (SBU) IMF resrep told us the IMF is concerned that BRSA's offer to the Cukurova Group may present problems for the Fund, in that the kind of valuations of shares that the BRSA appears willing to accept may add to a "sweet deal" for Cukurova. But resrep added that the IMF would not get in the middle of the negotiations between BRSA and Cukurova. Separately, HC Istanbul (an Istanbul brokerage) research director Huseyin Kelezoglu learned of the deal through his own BRSA contacts, and told us he sees the proposed swap as "very favorable to Cukurova." In effect, Cukurova would give up control of Yapi Kredi and some other lesser companies, but keep its shares of cash cow Turkcell, Turkey's largest cellphone operator (the company is currently valued at about \$3 billion, but was worth \$17 billion in 2000). This deal allows Karamehmet to keep his shares of Turkcell.

¶5. (SBU) Despite these views of a "sweet deal," Cukurova Group president Karamehmet probably won't agree to it, per BRSA's Pazarbasioglu. The deal would require him to give up control of Yapi Kredi which Karamehmet needs to continue funding the other, weak parts of the Group, per Pazarbasioglu. He has no incentive to strike a deal, she continued, because the deal involves the worst thing that can

happen to him - losing Yapi Kredi. Asked why the BRSA didn't press criminal fraud charges against Karamehmet (as it did in 2000 and 2001 against other bank owners who siphoned funds to bankrupt their banks), she summarized, "lack of political support."

Meanwhile, Yapi Kredi is Insolvent
or On Verge Thereof

¶16. (SBU) BRSA's Pazarbasioglu told us that Cukurova's failure to pay off its \$2.2 billion debt to Yapi Kredi is bankrupting the bank. Yapi's capital adequacy ratio is about 3 percent, she said. But, Cukurova has not paid Yapi in over a year; under banking rules Yapi should increase its loan loss provisioning for this non-performing loan from the current 50 percent to 100 percent. If Yapi was forced to fully provision for its Cukurova debt, the bank would have negative equity.

¶17. (SBU) Comment: The BRSA must under Turkey's banking law take over Yapi Kredi Bank if the bank has negative equity. But there is another provision of the banking law that could also be invoked in the case of Yapi Kredi: taking over a bank if its weakness poses a systemic risk to the banking system. Yapi Kredi fits this description, its deterioration poses systemic risks. With about \$7.5 billion in deposits, it has the second largest retail franchise among non-state banks in Turkey (only Isbank is larger), and is the leading T-bill trader for retail customers. It also has about \$2 billion in government securities among its own assets.

Karamehmet in the Bunker

¶18. (SBU) Yapi Kredi Exec VP Huseyin Imece told us Karamehmet is not thinking rationally about the BRSA deal. Imece agrees with others that Karamehmet should walk away happy if he gets to keep his main asset, the Turkcell shares. Instead, per Imece, Karamehmet worries about his reputation if he's seen to be kicked out of banking, and prefers to fight it out in the courts. He seethes, per Imece, at the bad press he gets from his rival Aydin Dogan (who owns more media than him and also owns Disbank). But Imece is very concerned with the reaction of Yapi Kredi creditors (it has about \$2 billion in exposure to foreign banks) if the January 31 deadline passes without a deal.

¶19. (SBU) Among the Karamehmet rivals that stand to benefit from his losing Yapi Kredi is the Koc Group. Kocbank acting CEO Kemal Kaya told us January 22 that Kocbank/Unito Credito remain very interested in buying Yapi Kredi from BRSA.

Comment

¶10. (SBU) Nearly everyone in the business community has some self interest at stake in the BRSA-Cukurova Group talks, and their views are naturally colored. But it's also true that the GOT must soon take charge of resolving this deteriorating situation at Yapi Kredi, either forcing Karamehmet to come to terms or taking over his remaining bank (and then collecting on his outstanding debts).

PEARSON